IN THE
SUPREME COURT OF MISSOURI

SC86441

SOUTHWESTERN BELL TELEPHONE COMPANY,

Respondent,

v.

DIRECTOR OF REVENUE,

Appellant.

Petition For Review
From The Administrative Hearing Commission,
The Honorable Karen A. Winn, Commissioner

APPELLANT'S REPLY BRIEF

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Argument

1. Beginning in its Statement of Facts, and continuing throughout the brief, respondent Southwestern Bell concedes a critical point: that the manufacturing of basic telephone service requires the equipment provided and used by the customer, not just the equipment provided and used by the telephone company. *See* Respondent's Brief ("Resp. Br.") at, *e.g.*, pp. 13, 31, 46. And nowhere does Southwestern Bell identify a single Missouri case in which the manufacturing exemption was applied to a process that took place on equipment owned, controlled, and operated by two unrelated entities.

At one point in its argument, Southwestern Bell implies that such authority can be found, in a backhanded sort of way, in *Concord Publishing House, Inc. v. Director of Revenue*, 916 S.W.2d 186 (Mo. banc 1996). Resp. Br. at 52. Southwestern Bell does not find the support in the *Concord Publishing* facts, of course, because there the companies involved were related. So it looks beyond *Concord Publishing* to a case cited there, *Central Paving Co. v. Idaho Tax Commission*, 879 P.2d 1107 (Idaho 1994). But as the Idaho court explained, there, too, the companies were related: "Central Paving is a paving contractor. Larry McEntree owns 85% of Central Paving and 50% of another company, Consolidated Concrete, Inc." 879 P.2d at

1108.

The fact remains that the decision of the AHC here (or the prior decision of this Court, if Southwestern Bell is right in its broad characterization of that opinion) breaks new ground. Never before has Missouri endorsed the proposition that the "integrated plant doctrine" or any other method of interpreting and applying § 140.030.2(4) & (5), RSMo. 2000, can be used to allow a company that leaves the key part of a manufacturing process to the customer to obtain the entire benefit of the "manufacturing" exemption.

2. The key question left by this Court's prior decision was what constitutes "basic" telephone service. Southwestern Bell describes it in a way that includes the entire telephone system. By specifically saying only that "basic" service is manufacturing, the Court implicitly concluded that there must be something within the telephone system that goes beyond "basic." Under Southwestern Bell's theory, it is unlikely that any such thing would exist. At most, it would be the equipment that is used for features for which they impose a separate charge, such as vertical services. Of course, Southwestern Bell successfully sought a holding that even that equipment is exempt, on the theory that the same equipment is used to such features that are within the scope of "basic" service. But if that separate holding is necessary despite the

broad definition of "basic" service, it is only because Southwestern Bell has yet to persuade regulators to include those services in basic tariffs. As far as we can tell, every aspect of telephone service that is included in basic tariffs would be, in the view of Southwestern Bell and the Administrative Hearing Commission, part of "basic" telephone service. If so, the Public Service Commission and the Federal Communications Commission would be empowered to modify Missouri sales tax law – a conclusion that makes no sense.

3. This set of facts – at least if the broad reading of "basic telephone service" is correct – points out the ludicrous lengths to which the "integrated plant doctrine" can be carried. That is particularly true as to "trunking facilities" – the facilities that connect central offices. Southwestern Bell tries to make the application "integrated plant doctrine" seem rational by comparing those trunking facilities to conveyor belts. *E.g.*, Resp. Br. at 32.

The Director does not suggest that all conveyor belts are excluded from the "manufacturing" exemption. But surely there is *some* limit. Southwestern Bell concedes none. In fact, in its view, a conveyor that extended from St. Louis to Kansas City – or even from coast to coast – would fall within the "manufacturing" exemption as part of an "integrated plant," merely because it

acts "harmoniously" with the manufacturing plants at both ends.

Like the question of multiple owners, the question of whether a connection between multiple facilities is itself "used directly" in manufacturing has never been addressed by this Court. The Court has certainly considered manufacturing that includes processes that take place at multiple locations. But it has never been asked to endorse, nor has it ever suggested, that the connection between those locations is itself part of the "manufacturing." The Court should use this case to reject the proposition, that no matter what form the connection between two manufacturing facilities may take, and no matter what the distance, the connection itself is "used directly" in manufacturing merely because of a "harmonious" connection at each end.

4. Southwestern Bell's suggestion that the Court apply a definition of "telephone service" derived from § 144.020.1(4) (Resp. Br. 58-59) lacks support in the statute. The section of the statute imposing tax rates (§ 144.020) is in no way parallel to that creating exemptions (§ 144.030). When the General Assembly first adopted the "manufacturing" exemption in 1961 (*See* Appellant's Brief at 31), it could have used language that would suggest a parallel to the telephone tax imposed decades earlier (*see* A.L. Extra Session 1933-34, H.B. 5, 155, 157). But it chose not to.

At times, Southwestern Bell seems to suggest that the General Assembly has chosen to exempt from sales tax any equipment that is used in creating a taxable product. But that is certainly not true. The exemptions are specific, covering only particular purchases, sometimes regardless of whether they are related to what is subsequently sold in a taxable transaction. Moreover, the exemptions are narrowly drawn (at least absent the kind of broad reading that Southwestern Bell urges here) and must be narrowly construed (*see Branson Properties USA, L.P. v. Director of Revenue*, 110 S.W.3d 824, 825 (Mo. banc 2003) ("Tax exemptions are strictly construed against the taxpayer.").

5. And the Court should reject the proposition that merely because some item makes use of manufacturing equipment more convenient or marketable, that item is "used directly" in manufacturing. The shelves and signs for pay telephones are the best example of the lengths to which Southwestern Bell will carry its argument. Those shelves are not anything like the laptops in *Concord Publishing*, as Southwestern Bell claims (Resp. Br. at 64). They are not "used" in manufacturing, as the laptops were. The signs and shelves are more like laps than laptops.

Nor are the signs and shelves like the bus-guards in *Noranda*

Aluminum, Inc. v. Missouri Department of Revenue, 599 S.W.2d 1 (Mo. 1980). *See* Resp. Br. at 63. The bus-guards prevented spillage of molten aluminum – spillage that is obviously incompatible with the safe manufacture of aluminum ingots. Telephone service can still be and is safely "manufactured" without signs, shelves, and similar accessories.

6. Twice Southwestern Bell suggests that the decision of the Director not to contest certain claims on remand constitutes a concession that has some dispositive or at least persuasive legal significance on appeal as to other equipment. Resp. Br. at 47 and 53 n.8. Missing is any authority for that proposition. There are myriad reasons the Director may choose not to contest the application of the exemption to particular items. We are aware of no authority for the proposition that by doing so, she was limiting her ability to contest the application of the exemption to other items. To create such authority would require the Director to contest far more claims than she now chooses to do, in order to prevent her choices from being used against her on appeal. Such a rule lacks support in logic and law, and would have negative implications on the efficient operation of administrative tribunals and the courts.

Similarly, Southwestern Bell tries to draw some support from the

decision of the Director not to pursue her appeal in *Missouri Dep't. of Revenue v. Digital Teleport, Inc.*, No. 04-3250 (8th Cir.). But again, the Director may have myriad reasons to settle rather than to continue fighting a battle over assets of a bankrupt company; there is no basis in logic or law for construing such a decision to have any impact on an appeal in another case, even if they raise overlapping legal issues. Neither the courts nor the Administrative Hearing Commission should engage in either fact-finding or speculation as to the basis for such strategic decisions.

Conclusion

For the reasons stated above and in the Appellant's Brief, the Court should reverse the decision of the Administrative Hearing Commission.

Respectfully submitted,

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Certification of Service and of Compliance with Rule 84.06(b) and (c)

The undersigned hereby certifies that on July 28, 2005, one true and correct copy of the foregoing brief, and one disk containing the foregoing brief, were mailed, postage prepaid, to:

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The undersigned further certifies that the foregoing brief complies with the limitations contained in Rule No. 84.06(b), and that the brief contains 1,525 words.

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